In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 678

GENERAL GEOPHYSICAL COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The petitioner corporation tentatively agreed to retire the stock of several stockholders by giving them $478,720 in cash and $746,525 face amount of notes. Legal counsel advised the stockholders, however, that there would be less risk of the notes being subordinated to the claims of other creditors in the event of insolvency if the corporation first transferred to the stockholders property worth $746,525 and the stockholders then retransferred the property to the corporation in exchange for the notes. To make the transfers effective for that purpose, they were further advised, it was important that the stockholders not be legally bound to make the retransfer (Pet. 3–4). The transaction was recast accordingly and, with the

necessary documents having been prepared in advance, was executed on February 25, 1954. On that date, the following occurred:

> (1) the corporation transferred to the retiring stockholders, in redemption of their stock, $478,720 in cash and assets with an agreed-upon value of $746,525; and
>
> (2) the retiring stockholders, although not legally bound to do so, reconveyed the assets to the corporation in exchange for notes in the amount of $746,525 secured by a deed of trust on all the properties of the corporation.[1]

The corporation's original cost basis for the assets, adjusted for depreciation previously taken, was $168,290. In its income tax return for 1954, however, the corporation claimed a new cost basis for the assets, for purposes of depreciation, in the amount of the notes given the stockholders ($746,525). The court of appeals, reversing the district court, held that the formal transfer and immediate reacquisition of the assets did not create a new cost basis for purposes of depreciation.

The decision below is clearly correct. While the conveyance and reconveyance of the legal title to the assets may have had independent legal significance for state law purposes—just as may, for example, the use of a "straw" corporation for conveyancing

[1] The assets transferred were operating assets of the corporation (drilling rigs, trucks, barges, office equipment, *etc.*) which remained in use, at job sites located in several states, throughout the course of the transaction.

purposes—they have none for federal income tax purposes. The self-cancelling transfers were admittedly but steps in a preconceived plan having as its sole object the transfer of validly-secured notes to the stockholders and the redemption of their stock.[2] In holding that the steps by which that result was achieved were not of independent significance for tax purposes—*i.e.*, that the tax consequences should be the same as they would be if the notes had been transferred initially—the court of appeals was simply applying to the particular context principles of tax law (the so-called "step-transaction" and "substance-over-form" doctrines) long ago established by this Court. *E.g.*, *Gregory* v. *Helvering*, 293 U.S. 465; *Helvering* v. *Clifford*, 309 U.S. 331; *Commissioner* v. *Court Holding Co.*, 324 U.S. 331.

Nor is there merit to the claim that the court of appeals exceeded the proper scope of review. In contending that the "clearly erroneous" standard was applicable, petitioner points to no dispute over any material question of fact. We concede, as did the court of appeals, that the stockholders, following sound advice, carefully avoided a binding legal commitment to carry out the planned retransfer and that there were non-tax reasons for the form of the transaction. Petitioner, on the other hand, does not attempt to deny that the entire transaction was planned

[2] In Maryland, for example, "straw" corporations are used to create "ground rents" without imposing a personal liability on the original purchaser. See *Welsh Homes, Inc.* v. *Commissioner*, 279 F. 2d 391 (C.A. 4).

in advance and executed according to plan.[3] The only disputed question was the question of law: does a transfer of assets to stockholders in redemption of their stock, immediately followed by a planned, but not legally compellable, retransfer of the assets to the corporation in exchange for notes, give rise to a new cost basis for purposes of depreciation? Even if a "clearly erroneous" standard could meaningfully be applied to such a question, moreover, it would be of no help to petitioner, for the "clear error" of the district court's answer to it is more than amply demonstrated by the court of appeals' opinion. Indeed, were so painless a method of obtaining a stepped-up basis for depreciation of even colorable efficacy, it would hardly have been overlooked for so long.

Petitioner asserts a conflict, on the scope of review question, with *United States* v. *McNair Realty Co.*, decided December 13, 1961 (C.A. 9) (printed at Pet. 45–47). That case involved neither a retransfer of property to the original owner nor a question of "basis," but rather a transfer to a stockholder followed by a sale by the stockholder to third parties and a question whether the "gain" on the sale should be attributed to the corporation. Cf. *Commissioner* v. *Court Holding Co.*, 324 U.S. 331; *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451. While the same basic principles may underlie the rules evolved in both areas, those principles

[3] If, contrary to our understanding, petitioner does mean to deny that the transaction was "planned," then our answer is that any such finding (which, however, the district court did not make) would be not merely "clearly erroneous."

are not self-defining absolutes and their application to differing problems depends upon the nature of the particular problem and of the distinctions sought to be made. The distinction, for example, between a sale by a corporation followed by a distribution of the proceeds to the stockholders and, on the other hand, a distribution in kind to the stockholders followed by a sale by them is itself largely a "formal" one since in either case the end results (though not the tax consequences) are substantially the same. With the basic distinction itself being one more of "form" than of "substance," broad principles of "substance over form" have not provided a ready answer and the courts have understandably found it difficult to articulate the precise incident that is controlling in making the distinction. It hardly follows, however, that the same ambiguity must exist in the application of "step-transaction" and "substance-over-form" principles to the question involved in this case. If the distinction between a retention of old assets and an acquisition of new is susceptible of being drawn by a sharper line than was the distinction involved in *McNair Realty*, there is no reason not to draw it. If the underlying purposes of the statute justify the rule—and quite different statutory provisions were involved in the two cases—the fact that a contemporaneous reacquisition was planned when the transfer was made may properly be held to be controlling for basis purposes (this case) whether or not the fact that a resale to third parties was planned when a distribution was made to the stockholders is, by itself, the controlling incident for gain-attribution purposes (the

McNair case). A difference in the specificity of the incident deemed controlling for the two different questions—and hence a difference in the questions to which the "clearly erroneous" standard applies—is not, therefore, a conflict of decisions; it is a product simply of the differing natures of the problems.

The decision is correct and there is no conflict. The petition for certiorari should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.

HARRY BAUM,
GILBERT E. ANDREWS, JR.,
Attorneys.

MARCH, 1962.